Auditi Issued under P				es	Repo	ort						
Local Governr  City			∐Villag	e ✓	Other	Local Governme	ent Name			County		
Audit Date <b>9/30/05</b>				on Date <b>7/06</b>	)		Date Accou 3/23/06	ntant Report Submi	itted to State:	•		
accordance	with th	e Sta	tements	of the	Govern	mental Accou	unting Star	ndards Board	d an opinion or (GASB) and th higan Departme	ne <i>Uniform</i>	Reportii	
We affirm the	nat:											
1. We hav	e compl	ied w	ith the <i>Bu</i>	lletin f	or the Au	ıdits of Local U	Jnits of Go	vernment in Mi	chigan as revis	ed.		
2. We are	certified	publ	ic accoun	ants r	egistered	d to practice in	Michigan.					
We further a comments a			_	s" resp	oonses h	ave been disc	closed in th	e financial state	ements, includi	ng the notes	, or in th	e report of
You must ch	eck the	applio	cable box	for ea	ch item b	pelow.						
Yes	<b>√</b> No	1. (	Certain co	mpone	ent units/	funds/agencie	es of the lo	cal unit are exc	luded from the	financial sta	tement	3.
Yes	<b>✓</b> No		There are 275 of 198		mulated (	deficits in one	or more o	of this unit's un	nreserved fund	balances/re	tained e	arnings (P.A
Yes	✓ No		There are amended)		nces of	non-complian	ce with the	Uniform Acco	ounting and Bu	udgeting Act	(P.A. 2	2 of 1968, as
Yes	✓ No							ther an order gency Municipa	issued under al Loan Act.	the Municipa	al Finar	ice Act or its
Yes	<b>√</b> No				-			do not comply amended [MC	/ with statutory CL 38.1132]).	requiremen	ts. (P.A	. 20 of 1943
Yes ,	✓ No	6.	The local	unit ha	ıs been d	delinquent in d	istributing t	ax revenues th	at were collect	ed for anothe	er taxin	g unit.
Yes ,	✓ No	7. p	ension b	enefits	(normal	I costs) in the	current ye	ar. If the plan	icle 9, Section is more than 1 ons are due (pa	00% funded	and th	-
Yes	✓ No		The local MCL 129		ises cred	dit cards and	has not a	dopted an app	olicable policy a	as required	by P.A.	266 of 1995
Yes	<b>✓</b> No	9. 7	The local	unit ha	s not add	opted an inves	stment poli	cy as required l	by P.A. 196 of	1997 (MCL 1	29.95).	
We have e	nclosed	the f	ollowing						Enclosed	To Be Forward		Not Required
The letter of	f comme	ents a	ind recom	menda	ations.				✓			
Reports on	individu	al fed	eral finan	cial as	sistance	programs (pro	ogram audi	ts).				<b>√</b>
Single Audi	t Report	s (AS	LGU).						✓			
Certified Publi			m Name)									
Street Address 5800 Gra		) Во	x 2025					City <b>Saginaw</b>		State MI	ZIP 4860	5

ΜI Date 3/23/06

## Financial Statements and Single Audit

For the Year Ended September 30, 2005



Your First Pathway to

Behavioral Health Care

in Jackson and Hillsdale



# LifeWays paths for personal growth

Jackson, Michigan

Financial Statements and Single Audit

For the Year Ended September 30, 2005

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#### **INDEPENDENT AUDITORS' REPORT**

January 17, 2006

The Board of Directors LifeWays Jackson, Michigan

We have audited the accompanying financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of *LifeWays* as of and for the year ended September 30, 2005, which collectively comprise LifeWays' basic financial statements as listed in the table of contents. These financial statements are the responsibility of LifeWays' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

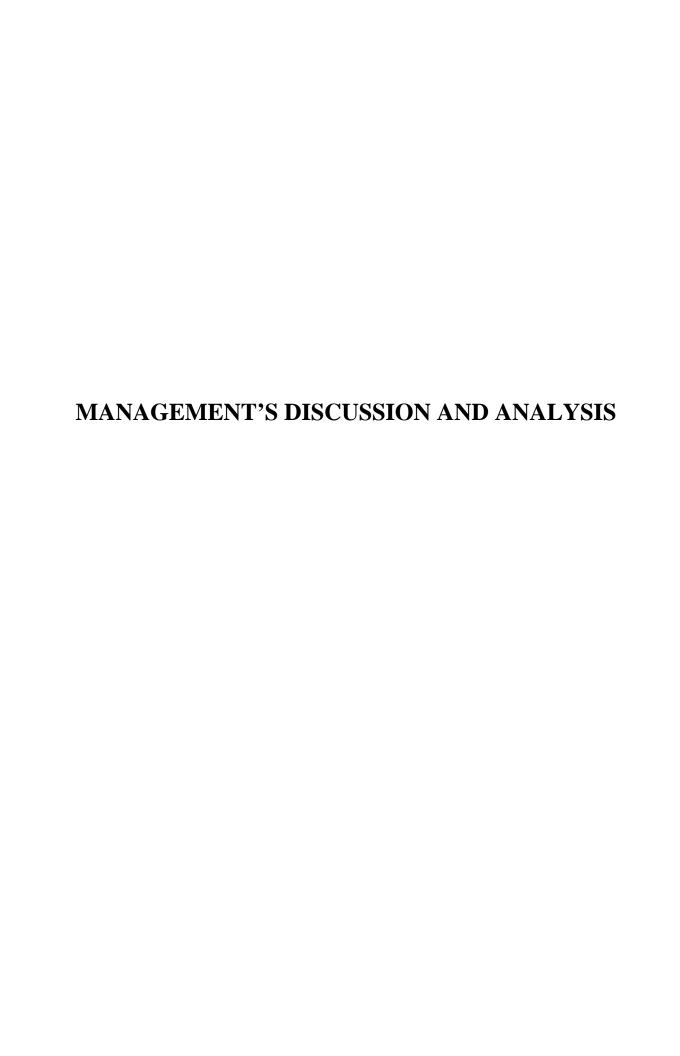
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities, the major fund, and the aggregate remaining fund information of LifeWays as of September 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 17, 2006, on our consideration of LifeWays' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis and GASB Statement 25 supplementary information listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise LifeWays' basic financial statements. The accompanying schedule of expenditures of federal awards, as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the combining fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Rehmann Lohan



## **LifeWays Management's Discussion and Analysis**

As management and administrators of LifeWays, we offer readers of LifeWays' financial statements this narrative overview and analysis of the financial activities of LifeWays for the fiscal year ended September 30, 2005.

#### **Overview of the Financial Statements**

- Total assets of LifeWays amounted to \$11,556,135 and total liabilities amounted to \$5,080,350 on September 30, 2005.
- LifeWays' total net assets increased by \$47,073 during the current year.
- As of the close of the current fiscal year, LifeWays reported ending net assets of \$6,475,785. Approximately 59% of this balance, or \$3,799,046 is available for spending at LifeWays' discretion (Operating Fund unrestricted net assets). An additional 10% or \$651,451 is invested in capital assets, net of related debt. The remaining 31%, or \$2,025,288, is to be held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH).

This discussion and analysis are intended to serve as an introduction to LifeWays' basic financial statements. LifeWays' basic financial statements are comprised of two components:

- 1) Government-wide/fund financial statements
- 2) Notes to the financial statements.

This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide/Fund Financial Statements. As permitted by GASB Statement No. 34, LifeWays uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements. These financial statements are designed to provide readers with a broad overview of LifeWays' finances, in a manner similar to a private-sector business. This is done by reporting LifeWays' assets and liabilities using the full accrual method of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The *Statement of Net Assets* presents information on all of LifeWays' assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of LifeWays is improving or deteriorating.

The Statement of Activities and Proprietary Fund Revenue, Expenses and Changes in Fund Net Assets presents information showing how LifeWays' revenue and expenses changed during the most recent fiscal year. All changes in revenue and expenses are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods. In addition, this statement discloses non-cash expenditures of depreciation and amortization, which affect the ending book value of capital assets.

The *Statement of Cash Flows* presents information about the source and usage of cash and cash equivalents and divides the information reported into three classifications: operating, financing, and investing. LifeWays' operations generate and use cash in the normal flow of activity: the collection of revenues and payments to contractors plus the non-cash activity add-backs such as depreciation. Financing activities include borrowing and repayment of long-term debt and purchase of equipment/group homes. Investing includes such items as investment of cash and other long-term assets.

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide/fund financial statements. The accompanying notes are an integral part of the financial statements and must be reviewed in conjunction with the information reported on the financial statements to provide a full understanding of LifeWays' financial situation.

#### **Government-wide Financial Analysis**

By far the largest portion of LifeWays' total assets (\$9,262,166 or 80%) reflects its cash and cash equivalents. These assets primarily constitute local resources. A portion of the cash balance (\$2,025,288) is held as Risk Reserve against potential liabilities relative to and as allowed by its contract with MDCH.

The second largest portion of LifeWays' total assets (\$1,451,451 or 13%) reflects its investment in capital assets (e.g., group homes, equipment, and furniture). LifeWays uses some of the capital assets (group homes) to provide services to the consumers it serves; consequently, these assets are *not* available for future spending and are considered fixed.

#### LifeWays' Total Assets & Net Assets

	<u>2004</u>	<u>2005</u>
Current and other assets Capital assets, net Total assets	\$ 10,435,049	\$ 10,104,684
Long-term liabilities outstanding Other liabilities Total liabilities	825,000 4,991,721 <b>5,816,721</b>	800,000 4,280,350 <b>5,080,350</b>
Net assets:     Invested in capital assets, net of related debt     Restricted     Unrestricted     Total net assets	764,736 2,026,978 3,416,350 <b>\$ 6,208,064</b>	651,451 2,025,288 3,799,046 <b>\$ 6,475,785</b>

#### LifeWays' Changes in Net Assets

	<u>2004</u>	<u>2005</u>
Operating revenue:  MDCH Contract Operating grants and contributions Charges for services and other local revenue	\$ 31,285,770 1,381,634 1,297,040 33,964,444	\$ 35,086,390 1,344,707 417,705 36,848,802
Operating expenses: Board administration Mental health services Substance abuse Depreciation and amortization	4,160,497 29,580,159 422,493 223,418 34,386,567	3,112,012 33,247,878 446,309 154,875 36,961,074
Operating income (loss)	(422,123)	(112,272)
Non-operating revenue (expense) Interest income Interest expense	138,450 (48,211) 90,239	206,295 (46,950) 159,345
Net income (loss)	(331,884)	47,073
Net assets, beginning of year, as restated	6,539,948	6,428,712
Net assets, end of year	<u>\$ 6,208,064</u>	<u>\$ 6,475,785</u>

#### Financial Analysis of LifeWays' Funds

As noted earlier, LifeWays uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

*Operating Fund* LifeWays accounts for its primary operations in an enterprise fund which is accounted for on the same basis of accounting as the government-wide financial statements. Accordingly, a separate analysis is not included herein.

*Internal Service Funds* The focus of LifeWays' internal service funds is used to account for assets held as a reserve against potential liabilities relative to and allowed by its contract with the Michigan Department of Community Health (MDCH). LifeWays' risk management plan has been reviewed and approved by MDCH.

At the end of the current fiscal year, LifeWays' internal service funds had combined net assets of \$2,025,288, a increase of \$44,067 in comparison with the prior year. The total amount is reserved to be used against possible operating expenses in excess of contract revenues within a specified risk corridor and consistent with LifeWays' risk management plan.

#### **Capital Asset and Debt Administration**

**Capital assets.** LifeWays' investment in capital assets for its activities as of September 30, 2005, amounted to \$1,451,451 (net of accumulated depreciation of \$1,138,331). This investment in capital assets includes group homes, leasehold improvements, and equipment. Net capital assets decreased by \$138,285 during the current fiscal year.

The only capital asset event during the current fiscal year was as follows:

• \$15,640 which was used for computer equipment.

Accumulated depreciation at September 30, 2005 amounted to \$1,138,331 and included current year depreciation expense of \$153,125.

#### LifeWays' Capital Assets

(Net of depreciation) September 30, 2005

Total	<u>\$</u>	1,451,451
Group homes		771,227
Leasehold improvements		561,132
other equipment		4,523
Furnishings and		
Computer equipment	\$	114,569

**Long-term debt.** At the end of the current fiscal year, LifeWays had general obligation bond debt outstanding of \$800,000. The current portion of bonded debt is \$25,000. These bonds were issued to finance the acquisition of five group homes for providing residential services to LifeWays' consumers.

#### Factors Bearing on LifeWays' Future

The following factors were considered in preparing LifeWays' budget for the 2005-06 fiscal year:

- Potential Executive Order cuts issued by the Governor to address unplanned state budget shortfalls.
- Increases in known and estimated costs namely, energy, health insurance, workers' compensation insurance and salary increases.
- An increasing trend in Medicaid-eligible consumers and the uninsured population related to increased unemployment and a sluggish economy.
- Potential building purchase.
- The final report of a required State audit, which could result in a financial liability, and threat to Internal Service Fund holdings.
- Potential Federal and State Medicaid cuts either through funding or service eligibility.
- 2005/2006 Rate rebasing by the State based on encounter data or actuarial analysis.
- New community service initiatives including:
  - ✓ Drug treatment courts
  - ✓ Mental health courts
  - ✓ Prisoner re-entry program
  - ✓ Service integration initiatives

#### **Requests for Information**

This financial report is designed to provide a general overview of LifeWays' finances for all those with an interest in LifeWays' finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Ivan Gibbs, CFO, LifeWays, 1200 N. West Ave., Jackson, Michigan 49202.



LifeWays Statement of Net Assets Proprietary Funds September 30, 2005

	Enterprise Operating Fund	Internal Service	Total Business-type Activities	
Assets				
Cash and cash equivalents	\$ 7,236,878	\$ 2,025,288	\$ 9,262,166	
Receivables:				
Fees, net of allowance for				
doubtful accounts of \$37,953	30,219	-	30,219	
Due from Michigan Department				
of Community Health	117,531	-	117,531	
Other	466,354	-	466,354	
Prepaid items	215,114	-	215,114	
Capital assets being depreciated, net	1,451,451	-	1,451,451	
Unamortized bond issuance costs	13,300	<u> </u>	13,300	
Total assets	9,530,847	2,025,288	11,556,135	
Liabilities				
Accounts payable	1,292,826	-	1,292,826	
Due to Michigan Department				
of Community Health	203,200	-	203,200	
Accrued liabilities	1,782,363	-	1,782,363	
Claims incurred but not reported	884,199	-	884,199	
Unearned revenue	117,762	-	117,762	
Long-term debt:				
Due within one year	25,000	-	25,000	
Due in more than one year	775,000	<u> </u>	775,000	
Total liabilities	5,080,350	<u> </u>	5,080,350	
Net assets				
Invested in capital assets, net of related debt	651,451	-	651,451	
Restricted for contract losses	-	2,025,288	2,025,288	
Unrestricted	3,799,046	<u> </u>	3,799,046	
Total net assets	\$ 4,450,497	\$ 2,025,288	\$ 6,475,785	

The accompanying notes are an integral part of these financial statements.

**LifeWays Statement of Activities and** 

### Proprietary Fund Revenue, Expenses, and Changes in Fund Net Assets For the Year Ended September 30, 2005

	Enterprise Operating Fund	Internal Service	Total Business-type Activities
Operating revenue			
Medicaid capitation	\$ 30,163,451	\$ -	\$ 30,163,451
State general fund indigent	4,922,939	-	4,922,939
Earned revenues, grants and federal programs	916,563	-	916,563
Substance abuse	428,144	-	428,144
Local revenue:			
County appropriations	94,135	-	94,135
First party	8,216	-	8,216
Third party	239,438	-	239,438
Other local revenue	75,916		75,916
Total operating revenue	36,848,802		36,848,802
Operating expenses			
Board administration	3,112,012	-	3,112,012
Mental health services	33,247,878	-	33,247,878
Substance abuse	446,309	-	446,309
Depreciation and amortization	154,875		154,875
Total operating expenses	36,961,074		36,961,074
Operating income (loss)	(112,272)		(112,272)
Non-operating revenue (expense)			
Interest income	162,228	44,067	206,295
Interest expense	(46,950)		(46,950)
Total non-operating revenue	115,278	44,067	159,345
Change in net assets	3,006	44,067	47,073
Net assets, beginning of year, as restated	4,447,491	1,981,221	6,428,712
Net assets, end of year	\$ 4,450,497	\$ 2,025,288	\$ 6,475,785

The accompanying notes are an integral part of these financial statements.

## **Statement of Cash Flows**

## **Proprietary Funds**

## For the Year Ended September 30, 2005

	Enterprise Operating Fund	Internal Service	
Cash flows from operating activities			
Cash received from customers and others	\$ 35,308,127	\$ (21,924)	
Cash payments to employees	(2,366,026)	-	
Cash payments to suppliers for goods and services	(33,795,888)		
Net cash used in operating activities	(853,787)	(21,924)	
Cash flows from capital and related financing activities			
Principal paid on bonds	(25,000)	-	
Interest paid on bonds	(46,950)	-	
Purchase of capital assets	(15,640)		
Net cash used in capital and			
related financing activities	(87,590)		
Cash flows from investing activities			
Interest received	162,228	44,067	
Net increase (decrease) in cash and cash equivalents	(779,149)	22,143	
Cash and cash equivalents, beginning of year, as restated	8,016,027	2,003,145	
Cash and cash equivalents, end of year	\$ 7,236,878	\$ 2,025,288	

continued...

### **Statement of Cash Flows**

## **Proprietary Funds (Concluded)**

## For the Year Ended September 30, 2005

	Enterprise Operating		
			internal
		Fund	 Service
Reconciliation of operating income (loss) to net cash			
provided by operating activities			
Operating income (loss)	\$	(112,272)	\$ -
Adjustments to reconcile operating income (loss)			
to net cash provided by operating activities:			
Depreciation and amortization		154,875	-
Changes in assets and liabilities:			
Fees receivable		(1,591)	-
Due from Michigan Department			
of Community Health		(11,367)	-
Other receivables		(254,436)	-
Prepaid items		(160,197)	-
Accounts payable		(356,264)	-
Due to Michigan Department			
of Community Health		(3,005)	-
Accrued liabilities		644,881	-
Claims incurred but not reported		518,870	-
Deferred revenue		(1,273,281)	 (21,924)
Net cash used in operating activities	\$	(853,787)	\$ (21,924)

The accompanying notes are an integral part of these financial statements.



#### **Notes to Financial Statements**

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of **LifeWays**, a Community Mental Health Authority established under Section 205 of the Michigan Mental Health Code, have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Government Accounting Standards Board (GASB) is the accepted standards-setting body for establishing governmental accounting and financial reporting principles. The more significant of LifeWays accounting policies are described below.

#### A. Reporting Entity

As indicated above, LifeWays is a Community Mental Health Authority serving the mental health needs of Jackson and Hillsdale County residents. Its Board of Directors is appointed by the County Commissions of Jackson and Hillsdale Counties.

#### **B.** Government-wide and Fund Financial Statements

As permitted by GASB Statement No. 34, LifeWays uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. Accordingly, this is presented in the Statement of Net Assets – Proprietary Funds and the Statement of Activities and Proprietary Fund Revenues, Expenses and Changes in Fund Net Assets. LifeWays' only major fund is reported in a separate column in the aforementioned financial statements.

The operations of LifeWays are accounted for as an Enterprise Fund (a proprietary fund) which is designed to be self-supporting. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the cost of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Risk Reserve Funds (which are both internal service funds, a proprietary fund type) are used to account for assets held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH). Pursuant to these contractual provisions, LifeWays risk management plan has been reviewed and approved by MDCH. Separate risk reserves are maintained for mental health and substance abuse services.

#### **Notes to Financial Statements**

#### C. Measurement focus, basis of accounting, and financial statement presentation

The government-wide and proprietary fund financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The enterprise fund is LifeWays' primary operating fund, and only major fund. It accounts for all financial resources of the government, except those required to be accounted for in another fund.

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The government has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of LifeWays' operating fund are contract revenues from MDCH and first and third party billings. Operating revenues of the internal service funds are primarily comprised of charges to other funds and governmental entities for risk financing. Operating expenses include the cost of providing mental health and substance abuse services. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

#### D. Assets, liabilities and equity

#### 1. Deposits

Cash and cash equivalents are considered to be cash on hand amounts in demand deposit accounts.

State statutes authorize units of local government to deposit in the accounts of federally insured banks, credit unions, and savings and loan associations, and to invest in obligations of the U.S. Treasury, certain commercial paper, repurchase agreements, bankers acceptances, and mutual funds composed of otherwise legal investments.

#### **Notes to Financial Statements**

#### 2. Receivables and Payables

Fee accounts receivable are shown net of an allowance for uncollectibles, which is based on management's estimate using collection history trends.

#### 3. Prepayments

Payments made to vendors for services that will benefit periods beyond September 30, 2005, are recorded as "prepaid items" in the accompanying statement of net assets.

#### 4. Capital Assets

Capital assets are capitalized and reported in the operating fund, net of accumulated depreciation. Capital assets are depreciated on the straight-line basis over the estimated useful lives of those assets, which range from five to forty years. All purchased capital assets are recorded at cost where historical records are available and at estimated historical costs where no historical records exist. Donated capital assets, if any, are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized.

#### 5. Compensated Absences

Vacation, sick leave and personal days cannot be carried over, and are not accrued in the accompanying financial statements.

#### 6. Unearned Revenue

Unearned revenue represents that portion of the current-year MDCH contract amount that may be carried-over to and expended in subsequent fiscal years. Such carryover is generally limited to five percent of the MDCH contract amount.

Medicaid Savings are considered local funds under the contract with MDCH, and may be spent over a period of several years in accordance with a Medicaid Reinvestment Strategy. State General Funds carried over must generally be spent in the following year.

#### **Notes to Financial Statements**

#### 7. Risk Management

LifeWays is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. During the year ended September 30, 2005, the entity carried commercial insurance to cover all risks of losses, except for any potential operating shortfalls under the terms of its contract with MDCH, which are covered by the Risk Reserve Internal Service Funds. LifeWays had no settled claims resulting from these risks that exceeded their commercial coverage in any of the past three fiscal years.

#### 2. DETAILED NOTES ON ALL FUNDS

#### A. Deposits

At year end, the carrying amount and bank balance of LifeWays' deposits were as follows:

	Carrying <u>Amount</u>	Bank <u>Balance</u>		
Demand accounts Imprest cash Jackson County Treasurer	\$ 79,724 400 	\$ 258,615 - - 9,182,042		
	<u>\$ 9,262,166</u>	<u>\$ 9,440,657</u>		

LifeWays' demand accounts are comprised of checking accounts with local banks with combined bank balances of \$258,615, of which \$158,115 was uninsured and uncollateralized.

As an Authority, LifeWays is authorized to deposit or invest in any accounts or institutions as permitted by State statutes. However, because of favorable terms, LifeWays has chosen to participate in Jackson County's investment pool, which is managed by the Jackson County Treasurer. These funds are deposited in the Treasurer's pooled accounts, and are deposited by and in the name of the Jackson County Treasurer. Other County funds are also deposited in those accounts and, as such, because of the complexities of FDIC Regulation #330.8, it is not possible to readily determine the amount of insurance that would be allocated to LifeWays' deposits.

#### **Notes to Financial Statements**

#### B. Due From/To Michigan Department of Community Health

For the year ended September 30, 2005, the operations of LifeWays were conducted under the terms and conditions of its contract with the MDCH.

The \$117,531 due from the MDCH represents amounts due for behavioral health services and other services provided by LifeWays. The receivable balance is comprised wholly of federal and state grants.

The \$203,200 due to the MDCH represents LifeWays' estimate of amounts payable to the State of Michigan for institutional care services provided by State institutions, certain amounts payable under the managed specialty supports and services contract, and the current year estimated cost settlement payable for the current year.

#### C. Capital Assets

Following is a summary of capital assets activity for the year ended September 30, 2005:

	<b>Beginning</b>			End
	of Year	Additions	<b>Deletions</b>	of Year
Cost				
Computer equipment	\$ 780,453	\$ 15,640	\$ -	\$ 796,093
Furnishings and other equipment	35,727	-	-	35,727
Leasehold improvements	842,947	-	-	842,947
Group homes	915,015	<del>_</del>		915,015
Total	2,574,142	15,640		2,589,782
Accumulated depreciation				
Computer equipment	588,505	93,019	-	681,524
Furnishings and other equipment	27,423	3,781	-	31,204
Leasehold improvements	250,833	30,982	-	281,815
Group homes	117,645	26,143		143,788
Total	984,406	<u>153,925</u>	<del>-</del>	1,138,331
Capital assets, net	<u>\$1,589,736</u>	<u>\$ (138,285)</u>	<u>\$</u>	<u>\$ 1,451,451</u>

#### **Notes to Financial Statements**

#### D. Long-term Debt

General Obligation Bonds. LifeWays uses general obligation bonds to provide funds for the acquisition and construction of major capital facilities. These bonds generally are issued as 20-year serial bonds with varying amounts of principal maturing each year. General obligation bonds currently outstanding are as follows:

Purpose	Interest <u>Rates</u>	Balance, Beginning of Year	<b>Deletions</b>	Balance, End of Year	Amount Due Within One Year
Series 1999 A Jackson County Building Authority Bonds (lease payable)	4.0 - 6.0%	<u>\$ 825,000</u>	<u>\$ 25,000</u>	<u>\$ 800,000</u>	<u>\$ 25,000</u>

The Jackson County Building Authority lease payable is equal to the aggregate outstanding principal and interest payments due on bonds issued by the Jackson County Building Authority, that pledge the full faith and credit of the government. Those bonds were issued to finance the acquisition of five group homes for providing residential services.

The requirements to amortize all debt outstanding at September 30, 2005, are as follows:

Year Ending						
September 30,	<u>P</u> ı	rincipal	Interest		Total	
2006	\$	25,000	\$	70,550	\$	95,550
2007		50,000		94,275		144,275
2008		50,000		91,675		141,675
2009		50,000		89,025		139,025
2010		50,000		86,375		136,375
2011-2015		275,000		415,325		690,325
2016-2019		300,000		345,000		645,000
Total	\$	800,000	\$ 1	,192,225	\$ 1	1,992,225

#### **Notes to Financial Statements**

#### E. Risk Reserve Fund Net Assets

At September 30, 2005, the net assets of the Risk Reserve Internal Service Funds were comprised of the following:

	Mental <u>Health</u>	Substance <u>Abuse</u>	<u>Total</u>		
Beginning balance, as restated Additions Deletions	\$1,948,336 43,322	\$ 32,885 745	\$1,981,221 44,067		
<b>Ending balance</b>	<u>\$1,991,658</u>	<u>\$ 33,630</u>	<u>\$2,025,288</u>		

#### Mental Health Risk Reserve

Under the terms of its managed specialty supports and services contract with MDCH, LifeWays is at risk for its operating expenses in excess of contract revenues within a specified risk corridor. In accordance with the contract, LifeWays is authorized and required to retain these funds until needed to offset actual operating losses within the risk corridor. LifeWays maximum risk exposure under the contract with MDCH is \$2,273,359, based on current funding levels (\$2,158,894 Medicaid, \$366,107 General Fund, and \$96,234 Local).

#### Substance Abuse Risk Reserve

Net assets in the substance abuse risk reserve are held on behalf of the Mid-South Substance Abuse Coordinating Agency. Contributions are made to the reserve by Mid-South as funds permit, and LifeWays distributes funds to Mid-South upon request.

#### **Notes to Financial Statements**

#### F. Retirement Plan

LifeWays has a single-employer defined benefit pension plan (the "LifeWays Pension Plan") for employees of LifeWays, which provides retirement, death and disability benefits covering substantially all of LifeWays' full-time employees. Membership of the Plan consisted of the following at October 1, 2004, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	9
Terminated plan members entitled to but not	
yet receiving benefits	55
Active plan members	48
	112

The Plan is non-contributory for employees; by Board Resolution, LifeWays is required to contribute at an actuarially determined rate all amounts necessary to provide assets sufficient to pay for member benefits. LifeWays' contribution to the Plan for the year ended September 30, 2005, represents 12.9% of the annual covered payroll.

The Plan is administered by a third-party insurance company. Administrative costs of the Plan are financed through investment earnings.

Plan provisions are established and amended under the authority of LifeWays' Board. Contribution requirements are established and amended subject to Board approval.

The Plan's annual retirement benefits cost and net retirement benefits obligation for the current year were as follows:

Net retirement benefit obligation, end of year	<u>\$</u>
Net retirement benefit obligation, beginning of year	
Increase (decrease) in net retirement benefit obligation	-
Contribution made	<u>(319,818</u> )
Annual required contribution / retirement benefit cost	\$319,818

The annual required contribution for the current year was determined as part of an actuarial valuation of the Plan as of September 30, 2005, using the aggregate actuarial cost method. The actuarial assumptions included: (a) a rate of return on investments of 13.5%; (b) projected salary increases of 2.5% attributable to inflation; and (c) the assumption that the excess of the present value of benefits over valuation assets is spread over the average working lifetime of plan participants.

#### **Notes to Financial Statements**

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis over 30 years from April 15, 1992.

#### **Three-Year Trend Information**

Year <u>Ending</u>	Annual Retirement Benefit Cost (ARBC)	Percentage of ARBC Contributed	Net Retirement Benefit Obligation
9/30/2003	\$336,528	100.0%	\$ -
9/30/2004	319,537	100.0%	-
9/30/2005	319,818	100.0%	-

GASB Statement 25 required supplementary information is presented after the Notes to Financial Statements section of this report.

#### G. Claims Incurred But Not Reported

LifeWays estimates the liability for contractual services provided by its contract providers that have been incurred through the end of the fiscal year, including both those claims that have been reported as well as those that have not yet been reported. Changes in the estimated liability are as follows:

Estimated liability, end of year	\$ 884,199
Claim payments	(13,252,405)
Estimated claims incurred	13,771,275
Estimated liability, beginning of year	\$ 365,329

#### **Notes to Financial Statements**

#### H. Contribution to the King Trust Charitable Gift Fund

In 2002, LifeWays made contributions to the King Trust Charitable Gift Fund (the "Fund"), to establish the "LifeWays Foundation" account. While LifeWays may make recommendations regarding the use of the Fund, any contributions made are irrevocable and become assets of the Fund. Since LifeWays is not the trustee of the LifeWays Foundation account, and does not exercise any control over the Fund's assets, no amounts were recorded in these financial statements at year end. The balance in the LifeWays Foundation account at September 30, 2005 was \$6,332.

#### I. Contingencies and Commitments

Under the terms of various Federal and State grants and regulatory requirements, LifeWays is subject to periodic audits of its agreements. Such audits could lead to questioned costs and/or requests for reimbursement to grantor or regulatory agencies.

As is the case with other entities, LifeWays faces exposure from potential claims and legal proceedings involving environmental and other matters. No such claims or proceedings have been asserted as of September 30, 2005.

#### J. Restatements

Beginning net assets of the operating fund were increased by \$266,405 and beginning net assets of the mental health risk reserve were decreased by \$45,757 to reflect adjustments made to the 2003 and 2004 cost settlement reports by MDCH.

\* \* \* \* \* \*

## GASB REQUIRED SUPPLEMENTARY INFORMATION

## LifeWays GASB Statement 25 Required Supplementary Information Employee Retirement System

#### **Schedule of Funding Progress**

Actuarial Valuation Date Oct. 1	A	ctuarial Value of Assets	Lial	(2) Actuarial Accrued bility (AAL) Cntry Age	J)	(3) Ifunded AAL JAAL) (2-1)	]	Funded Ratio Cove		(5) Covered Payroll	(6) UAAL as % of Covered Payroll (3/5)	
1995	\$	565,733	\$	1,124,057	\$ :	558,324		50.3 %	\$	2,533,691		22.0 %
1996		891,391		1,846,011	(	954,620		48.3		2,649,503		36.0
1997		1,382,713		1,814,743		432,030		76.2		2,840,510		15.2
1998		1,445,894		2,222,694	,	776,800		65.1		2,464,317		31.5
1999		1,809,122		2,380,312	:	571,190		76.0		2,576,654		22.2
2000		2,236,469		2,793,508		557,039		80.1		2,271,312		24.5
2001		2,157,775		2,349,783		192,008		91.8		2,337,520		8.2
2002		2,214,182		2,708,063		493,881		81.8		1,948,381		25.3
2003		2,775,533		3,617,533		842,000		76.7		1,940,994		43.4
2004		3,401,945		3,975,950	:	574,005		85.6		2,197,653		26.1

#### **Schedule of Employer Contributions**

Fiscal Year Ended Sept. 30	Contribution Rates as Percents of Valuation Payroll	Valuation Payroll	Annual Required Contribution	Annual Actual Contribution	Percentage Contributed
1996	9.9 %	\$ 2,649,503	\$ 262,964	\$ 262,964	100.0 %
1997	10.0	2,840,510	283,998	283,998	100.0
1998	9.4	2,464,317	230,891	230,891	100.0
1999	11.8	2,576,654	303,890	303,890	100.0
2000	12.4	2,271,312	280,974	280,974	100.0
2001	10.9	2,337,520	255,090	255,090	100.0
2002	14.4	2,149,106	310,429	310,429	100.0
2003	17.3	1,948,381	336,528	336,528	100.0
2004	16.5	1,940,994	319,537	319,537	100.0
2005	12.9	2,197,653	319,818	319,818	100.0

## SUPPLEMENTARY INFORMATION

## LifeWays Combining Statement of Net Assets - Internal Service Funds September 30, 2005

	Mental Health Risk Reserve	Substance Abuse Risk Reserve	Totals
Assets Cash and cash equivalents	\$ 1,991,658	\$ 33,630	\$ 2,025,288
Liabilities Unearned revenue			- <u>-</u>
Net assets Restricted for contract losses	\$ 1,991,658	\$ 33,630	\$ 2,025,288

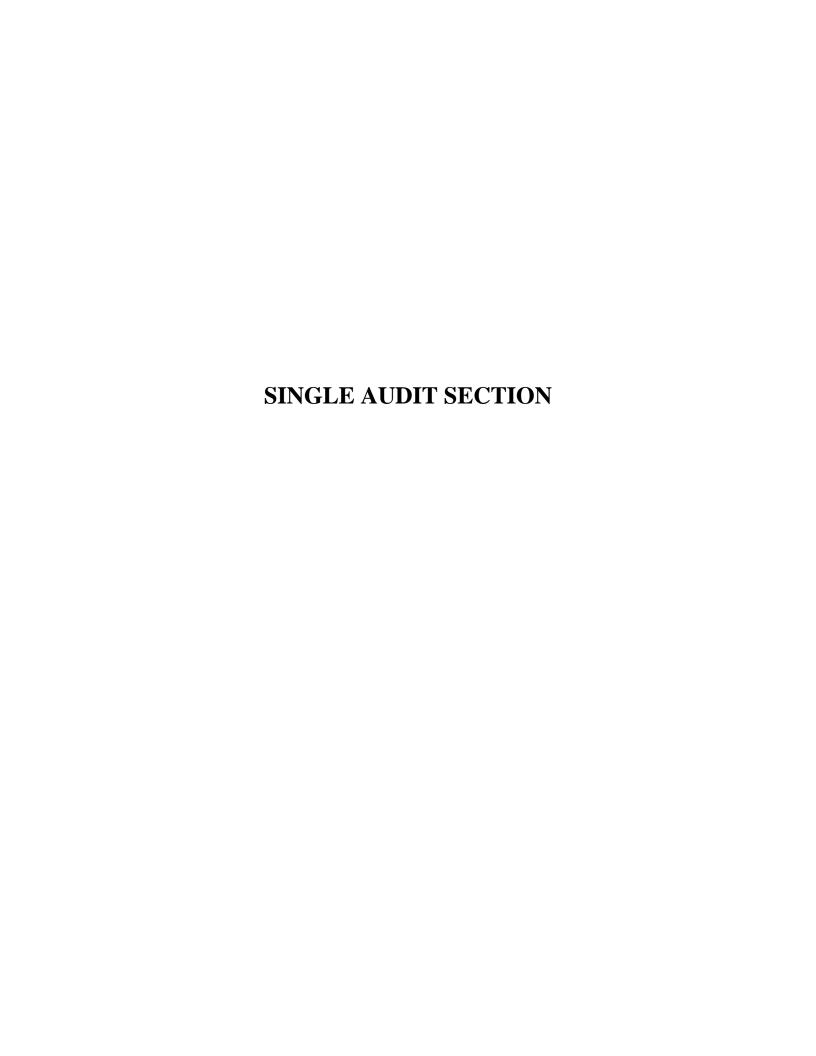
## Combining Statement of Revenue, Expenses and Changes in Net Assets - Internal Service Funds For the Year Ended September 30, 2005

	Mental Health Risk Reserve			bstance Abuse Reserve	Totals	
Operating revenue						
Charges for services	\$	-	\$	-	\$	-
Non-operating revenue						
Interest income		43,322		745		44,067
Change in net assets		43,322		745		44,067
Net assets, beginning of year, as restated	1	,948,336		32,885		1,981,221
Net assets, end of year	\$ 1	,991,658	\$	33,630	\$	2,025,288

## Combining Statement of Cash Flows Internal Service Funds

## For the Year Ended September 30, 2005

	Mental Health Risk Reserve			ubstance Abuse k Reserve	Totals	
Cash flows from operating activities	Φ		Φ	(21.024)	Ф	(21.024)
Cash payments to vendors and others	\$	-	\$	(21,924)	\$	(21,924)
Cash flows from investing activities						
Interest received		43,322		745		44,067
Net increase (decrease) in cash and cash equivalents		43,322		(21,179)		22,143
Cash and cash equivalents, beginning of year, as restated		1,948,336		54,809	2	2,003,145
Cash and cash equivalents, end of year	\$	1,991,658	\$	33,630	\$ 2	2,025,288
Reconciliation of operating income to net cash provided by operating activities  Operating income  Adjustments to reconcile operating income to net cash provided by operating activities:  Changes in assets and liabilities:  Unearned revenue	\$	- -	\$	(21,924)	\$	(21,924)
Net cash provided by operating activities	\$	_	\$	(21,924)	\$	(21,924)



## LifeWays Schedule of Expenditures of Federal Awards For the Year Ended September 30, 2005

E-land Country		Grant			
Federal Grantor/ Pass-through Grantor/	CFDA		Award Federal	ī	ederal
Program Title	Number		Share)		enditures
				<u></u>	
U.S. DEPARTMENT OF HEALTH AND					
HUMAN SERVICES					
Passed-through the Hillsdale County					
Family Independence Agency					
Title IV-B Subpart 2 Family					
Preservation and Support Services -					
Wraparound (WRAP)	93.556	\$	13,165	\$	13,165
Passed-through the Michigan					
Department of Community Health					
Projects for Assistance in Transition					
from Homelessness (PATH)	93.150		30,460		30,460
Omnibus Budget Reconciliation Act -					
Preadmission Screenings and Annual					
Resident Reviews (OBRA-PASARR)	93.778		153,346		115,009
Consumer Cooperative for CMS	93.779		211,284		168,133
Block Grants for Community Mental Health Services:	93.958				
SED Respite Services			20,016		20,016
Wraparound Services			57,416		57,416
Juvenile Justice Diversion			40,000		40,000
Anti-Stigma			52,548		52,548
Mental Health Recovery Initiative			55,006		49,311
Rural Disease Management			23,800		13,780
			248,786		233,071
TOTAL EXPENDITURES OF FEDERAL AWARDS		\$	657,041	\$	559,838

## LifeWays

## Notes to Schedule of Expenditures of Federal Awards

#### 1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of LifeWays and is presented on the accrual basis of accounting.

The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

\* \* \* \* \* \*



# INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

January 17, 2006

The Board of Directors LifeWays Jackson, Michigan

We have audited the financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of *LifeWays* as of and for the year ended September 30, 2005, which collectively comprise LifeWays' basic financial statements as listed in the table of contents, and have issued our report thereon dated January 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

## **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered LifeWays' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

#### **Compliance And Other Matters**

As part of obtaining reasonable assurance about whether LifeWays' basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of the LifeWays Board, management, others in the organization, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rehmann Loham



## INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO A MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

January 17, 2006

The Board of Directors LifeWays Jackson, Michigan

#### Compliance

We have audited the compliance of *LifeWays* with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended September 30, 2005. LifeWays' major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of LifeWays' management. Our responsibility is to express an opinion on LifeWays' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about LifeWays' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on LifeWays' compliance with those requirements.

In our opinion, LifeWays complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2005.

### **Internal Control Over Compliance**

The management of LifeWays is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered LifeWays' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the LifeWays Board, management, others in the organization, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rehmann Loham

## LifeWays

## **Schedule of Findings and Questioned Costs**

## For the Year Ended September 30, 2005

## **SECTION I - SUMMARY OF AUDITORS' RESULTS**

## Financial Statements

Type of auditors' report issued:	<u>Unqualified</u>
Internal control over financial reporting:	
Material weakness(es) identified?	yes <u>X</u> no
Reportable condition(s) identified not considered to be material weaknesses?	yes <u>X</u> none reported
Noncompliance material to financial statements noted?	yes <u>X</u> no
Federal Awards	
Internal Control over major programs:	
Material weakness(es) identified?	yes <u>X</u> no
Reportable condition(s) identified not considered to be material weaknesses?	yes <u>X</u> none reported
Type of auditors' report issued on compliance for major programs:	<u>Unqualified</u>
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section 510(a)?	yes <u>X</u> no

## LifeWays

## **Schedule of Findings and Questioned Costs (Concluded)**

## For the Year Ended September 30, 2005

SECTION I - SUMMARY OF AUDITORS' RES	SULTS (Concluded)
Identification of major program:	
<u>CFDA Number(s)</u>	Name of Federal Program or Cluster
93.779	Consumer Cooperative for CMS
Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$300,000</u>
Auditee qualified as low-risk auditee?	X yes no
SECTION II – FINANCIAL STATEMENT FIN	DINGS
None.	
SECTION III – FEDERAL AWARD FINDINGS	S AND QUESTIONED COSTS
None.	
SECTION IV – PRIOR YEAR FINDINGS	
None.	

\* \* \* \* \* \*



January 17, 2006

Board of Directors LifeWays Jackson, Michigan

We have audited the financial statements of *LifeWays* for the year ended September 30, 2005 and have issued our report thereon dated January 17, 2006. Professional standards require that we provide you with the following information related to our audit.

### **Our Responsibility Under Generally Accepted Auditing Standards**

As stated in our engagement letter dated August 2, 2005, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with generally accepted accounting principles. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

As part of our audit, we considered the internal control of LifeWays. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

#### **Significant Accounting Policies**

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we advised management about the appropriateness of accounting policies and their application. The significant accounting policies used by LifeWays are described in Note 1 to the basic financial statements.

## **Accounting Estimates**

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

• Management's estimate of the liability for claims incurred but not reported. We evaluated the key factors and assumptions used to develop the amount of the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

- Management's estimate of the useful lives of its capital assets. We evaluated the key factors and assumptions used to develop the useful lives of those assets in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of its maximum risk exposure under its contract with MDCH. This estimate is the basis for determining whether the amount in the risk reserve internal service fund is within allowable limits. We evaluated the key factors and assumptions used to develop LifeWays' Risk Management Plan in determining that it is reasonable in relation to the financial statements taken as a whole.

## **Significant Audit Adjustments**

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on LifeWays' financial reporting process (that is, cause future financial statements to be materially misstated). We proposed several adjustments related to the proper accounting for various transactions. These proposed adjustments were all recorded by LifeWays, and in our judgment, in the aggregate, had a significant effect on LifeWays' financial reporting process.

In addition, other receivables, as shown on the financial statements, include an amount due from Hillsdale County that does not agree with the amount confirmed by the County as being owed to LifeWays. This has the effect of overstating receivables and revenue by \$11,262. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

#### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

### **Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to LifeWays' financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, professional standards require the consulting accountant to confer with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

#### **Issues Discussed Prior to Retention of Independent Auditors**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as LifeWays' auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

## **Difficulties Encountered in Performing the Audit**

We encountered no difficulties in dealing with management in performing our audit.

This information is intended for the use of the LifeWays Board, management, others in the organization, and the state and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Rehmann Loham

## LifeWays Comments and Recommendations For the Year Ended September 30, 2005

During our audit we became aware of certain matters that are opportunities for strengthening internal control and operating efficiency. This memorandum summarizes our comments and recommendations regarding those matters. A separate report dated January 17, 2006, contains our report on reportable conditions in LifeWays' internal control structure. This memorandum does not affect our report dated January 17, 2006, on the basic financial statements of LifeWays.

We will review the status of these comments during our next audit engagement. We have already discussed these matters with management and we will be pleased to discuss them in further detail at your convenience, or to provide assistance in implementing the recommendations.

## <u>Internal Controls – Segregation of Duties</u>

Management is responsible for establishing and maintaining effective internal control over financial reporting and the safeguarding of LifeWays' assets. In establishing appropriate internal controls, careful consideration must be given to the cost of a particular control and the related benefits to be received. Accordingly, management must make the difficult decision of what degree of risk it is willing to accept, given the government's unique circumstances.

As is the case with many organizations of similar size, LifeWays lacks a sufficient number of accounting personnel in order to ensure a complete segregation of duties within its accounting function. Ideally, no single individual should ever be able to authorize a transaction, record the transaction in the accounting records, and maintain custody of the assets resulting from the transaction. Effectively, proper segregation of duties is intended to prevent an individual from committing an act of fraud or abuse and being able to conceal it.

Events of recent years have given rise to a heightened awareness of the risks of fraud and abuse, especially in the governmental environment, where public accountability is at its highest. The purpose of internal controls is to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are properly authorized and recorded. Any limitations on the effectiveness of a government's internal controls carries with it a greater risk of fraud and abuse.

As stated previously, the establishing and maintaining of internal controls is the responsibility of management. As LifeWays' independent external auditors, we are specifically banned by professional standards from performing any management functions. In other words, the annual audit is <u>not</u> a part of LifeWays' internal control structure, and cannot not be relied upon as part of *management's* systems to deter or detect fraud and abuse.

While there are, of course, no easy answers to the challenge of balancing the costs and benefits of internal controls and the segregation of duties, we would nevertheless encourage management to actively seek ways to further strengthen its internal control structure by requiring as much independent review, reconciliation, and approval of accounting functions by qualified members of management as possible.

## LifeWays Comments and Recommendations (Concluded) For the Year Ended September 30, 2005

#### **Audit Process and Preparation**

As you know, this year's audit was completed quite a bit later than usual, owing principally to the additional time required by management to prepare the various records and schedules needed for the audit. This condition was caused by several different personnel matters, including the medical leave of certain key employees.

Given the circumstances, management did a commendable job of preparing for the audit while short of staff, and we would like to extend our thanks to those who expended the extra effort and tackled areas that have not previously fallen within their areas of responsibility. However, we believe that this condition underscores the need for further cross-training and strategic assignment of financial duties among the members of LifeWays' Finance Team. This will both enhance internal controls (by involving additional individuals in key processes) and reduce the short-term impact of the absence of any single employee.

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